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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, ~~1931~~ 32

No. ~~824~~ 26

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

HENRY HARMEL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 24, 1932
CERTIORARI GRANTED APRIL 18, 1932

(36638)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1931

No. 824

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

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INDEX

	Original	Print
Proceedings in U. S. C. C. A., Fifth Circuit	A	1
Caption (omitted in printing)	A	1
Proceedings before U. S. Board of Tax Appeals	1	1
Docket entries	1	1
Petition	2	2
Exhibit—Deficiency letter	6	3
Answer	13	7
Findings of fact and opinion, Marquette, M	14	8
Decision	18	10
Petition for review	19	11
Assignment of errors	22	13
Præcipe	23	13
Stipulation as to leases	25	14
Exhibit—Oil and gas lease between Henry Harmel and E. R. Fain, 10/13/24	25	14
Exhibit—Oil and gas lease between Henry Harmel and J. A. Gardner, 10/21/24	30	17
Argument and submission (omitted in printing)	35	20
Opinion, Bryan, J	36	20
Judgment	38	21
Motion for stay of mandate	39	21
Order staying mandate	40	22
Clerk's certificate (omitted in printing)	41	22
Order allowing certiorari	42	22

A [Caption omitted.]

1 Before United States Board of Tax Appeals

Docket No. 38855

HENRY HARMEL, PETITIONER

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearance:
For taxpayer, Robert Ash, Esq., Thos. J. Reilly, Esq.
For. commr., J. A. Adams, Esq.

Docket entries

1928
May 23—Petition received and filed. Taxpayer notified. (Fee paid.)
May 24—Copy of petition served on general counsel.
May 24—Notice of appearance of Robt. Ash & Thos. J. Reilly as counsel for taxpayer filed.
July 3—Answer filed by G. C.
July 14—Copy of answer served by taxpayer. General calendar.
1929
May 29—Motion to place on the Wichita Falls, Texas, circuit calendar, filed by taxpayer. 5/31, granted.
Oct. 17—Hearing set, Nov. 27, 1929, at Dallas, Texas.
Nov. 27—Hearing had before J. J. Marquette, div. 1, on the merits. Submitted. Briefs due 2/1/30.
Dec. 31—Transcript of hearing, 11/27/29, filed.
1930
Jan. 31—Brief filed by taxpayer.
Mar. 24—Findings of fact and opinion rendered; Mr. Marquette, div. 1. Judgment will be entered under rule 50.
Apr. 5—Notice of settlement filed by G. C.
Apr. 9—Hearing set, April 30/30, on settlement.
Apr. 21—Consent to settlement filed by taxpayer.
Apr. 25—Judgment entered; J. J. Marquette, div. 1.
Oct. 25—Petition for review to U. S. Circuit Court of Appeals, 5th Circuit, with assignments of error filed by taxpayer.
Oct. 25—Proof of service of petition filed.
Oct. 25—Designation of record filed.
Oct. 25—Proof of service filed.

Now, March 14, 1931, the foregoing docket entries certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed May 23, 1928

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT: FAR: B-1—IMB-60D) dated April 4, 1928, and as a basis of his proceeding alleges as follows:

3 1. The petitioner is an individual whose address is Megargel, Texas.

2. The notice of deficiency, a copy of which is attached and made a part of this petition, dated April 4, 1928. The petitioner has no knowledge as to the date it was mailed.

3. The taxes in controvery are income taxes for the calendar years 1924 and 1926 in the amounts of $2,587.24 and $367.68, respectively, and an overassessment for the year 1925 in the amount of $727.78.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The commissioner erred in refusing to allow depletion on cash bonuses received for leasing proven oil land.

(b) If the commissioner is correct in refusing to allow depletion on bonuses as referred to in paragraph 4 (a), he erred in refusing to tax the sale of the leases as a sale of capital assets.

(c) The commissioner erred in adding to gross income "unidentified" bank deposits of $1,000 and $500, made December 5 and December 24, 1924, respectively.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) and (b). (1) For more than two years prior to 1924 petitioner was the owner in fee of the whole of block 2401 of the T. E. & L. survey, Archer County, Texas, which consisted of 320 acres. Prior to October 13, 1924, the block was proven for oil production.

4 (2) On October 13, 1924, the petitioner leased to Murchison, Fain and Golding the west 40 acres of the south half of block 2401 for $20,000 in cash and $20,000 to be paid out of 7/16ths of the gross production of the lease; $2,562.54 of the oil payment was received in 1924, and $17,437.46 was received in 1925.

(3) On October 21, 1924, the petitioner leased to J. A. Gardner the 80 acres in the south half of block 2401 adjoining the 40 acres leased to Murchison, Fain and Golding for $44,000 in cash and $44,000 to be paid in oil. None of the oil payment was received in 1924; $36,780.03 of the oil payment was received in 1925. The lease to Gardner required the drilling of certain wells on the lease, the first to be drilled within 30 days.

(4) Two other leases were sold off block 2401 by petitioner, for which he received bonuses of $3,000.

(5) In adjusting the tax liability of the petitioner the respondent refused to allow depletion on the $64,000 oil-lease bonuses received in cash. Instead, respondent took the $64,000 plus the $3,000 bonus received from the other leases mentioned in subparagrap' (4), deducted $10,000 commissions paid, and treated the $57,000 figure thus arrived at as proceeds from lease sales, whereas the whole of the $64,000 should have been treated as prepaid royalties.

(6) The respondent added to gross income a deposit of $1,000 made December 5, 1924, in the Megargle State Bank and a deposit of $500 made December 24, 1924, in the same bank. Both the deposits were transfers from the petitioner's account in the First National Bank of Wichita Falls to the petitioner's account in the Megargle State Bank, and neither in any way represented income.

5 Wherefore, petitioner prays that this board may hear the proceeding and

(a) Determine that the cash bonuses received from Murchison, Fain and Golding, and J. A. Gardner were prepaid royalties subject to depletion.

(b) In the event the board determines the cash bonuses referred to were not prepaid royalties, determine that the lease sales were sales of capital assets.

(c) Determine that the deposits of $1,000 made December 5, 1924, and $500 made December 24, 1924, in the Megargle State Bank should not be included in income.

(d) Grant such other and further relief as the board may deem proper.

ROBERT ASH,
THOMAS J. REILLY,
Munsey Building, Washington, D. C.,
Attorneys for Petitioner.

PARFET & MARTLEW,
Wichita Falls, Texas,
Of Counsel.

[*Duly sworn to by Henry Harmel; jurat omitted in printing.*]

6 *Exhibit to petition*

TREASURER DEPARTMENT,
Washington, Apr. 4, 1928.

MR. HENRY HARMEL,
Megargel, Texas.

SIR: In accordance with section 274 of the revenue act of 1926, you are advised that the determination of your tax liability for the year 1924, 1925, and 1926 discloses a deficiency of $2,954.92 for the years 1924 and 1926 and an overassessment of $727.78 for the year 1925, as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the enclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully, D. H. BLAIR,
Commissioner.

By (Sgd.) C. R. ALLEN,
Deputy Commissioner.

Enclosures: Statement; Form A; Form 882.

7 STATEMENT

IT:FAR:B-1—IMB-60D. APR. 4, 1928.

In re: Mr. Henry Harmel, Megargel, Texas

Years	Deficiency in tax	Overassessment
1924	$2,587.24	
1925		$727.78
1926	367.68	
Totals	2,954.92	727.78

The report of the internal revenue agent in charge, Dallas, Texas, covering an investigation of your income-tax returns for the years 1924 to 1926, inclusive, has been reviewed and approved by this office.

1924

Net income reported on return		$2,016.57
Add:		
1. Increase in business income	$2,177.52	
2. Depletion disallowed	2,259.18	
3. Increase in oil income	51.00	
4. Right-of-way sales	22.50	
5. Bonus income	57,000.00	
		61,510.20
Net income adjusted		63,526.77

COMPUTATION OF TAX

Net income adjusted	63,526.77
Less: Exemption	1,000.00
Income subject to normal tax	62,526.77
8 Normal tax, at 2%, on $4,000.00	80.00
Normal tax, at 4%, on $4,000.00	160.00
Normal tax, at 6%, on $54,526.77	3,271.61
Surtax on $63,526.77	6,235.88
Total tax	9,747.49
Brought forward	9,747.49
Less: Credit of 25% for earned net income	20.00
Total tax assessable	9,727.49
Tax previously assessed	7,140.25
Deficiency in tax	2,587.24

Explanation of changes

1. As shown in Schedule number 2 of the agent's report, the increase in business income is due to the following changes:

Gross sales increased	$777.02
Unidentified deposits not reported	1,500.00
Plowing expenses allowed	80.00
Abstract fees increased	19.50

2. The deduction for depletion has been decreased from $3,511.94 to $1,252.76. The amount of depletion was limited to 50% of the income of $2,505.52 received from oil royalty received in accordance with article 201 (h), revenue act of 1924.

3. The increase of $51.00 in oil income is due to an amount disclosed by oil-run tickets which was not reported.

4. The increase of $22.50 in the right-of-way sales represents an amount not included in the total of $165.50 reported by you.

9 5. The bonus income of $57,000.00 represents lease sales, the tax on which has been computed under section 208 (b) in your return, whereas it has been treated as bonus income taxable at ordinary rates. (See Income Tax Unit decision number 2077, Cumulative Bulletin III–2, page 47.)

1925

Net income reported on return			$105,147.16
Add:			
1. Royalty income		$24,014.60	
Deduct:			
2. Bonus income	$5,411.90		
3. Depletion increase	21,513.83		
		26,925.73	
			2,911.13
Net income adjusted			102,236.03

COMPUTATION OF TAX

Net income adjusted	$102,236.03
Less: Exemption	1,500.00
Income subject to normal tax	100,736.03
Normal tax, at 1½%, on $4,000.00	60.00
Normal tax, at 3%, on $4,000.00	120.00
Normal tax, at 5%, on $92,736.03	4,636.80
Surtax on $102,236.03	12,107.21
Total tax	16,924.01
Less: Credit of 25% for earned net income	13.13
Total tax assessable	16,910.88
Tax previously assessed	17,638.66
Overassessment	727.78

10 Explanation of changes

1. Reconciliation of royalty income difference:

Texhoma Oil Company, ⅛ interest	$10,947.49
Harmel, A ⅛ interest, Murcheson, Fain, and Golding	37,600.94
Harmel, C ⅛ interest, Murcheson, Fain, and Golding	51,904.07
Total royalty on oil received	100,452.50
Total royalty on oil reported	76,437.90
Increase in royalty income	24,014.60

2. Reconciliation of difference in lease sale bonuses:

Harmel, ⅛ interest, Texhoma Oil Company	$36,780.03
Harmel, 6⅛, Murcheson, Fain, and Golding	17,437.46
Total bonus oil received	54,217.49
Brought forward	54,217.49
Total bonus oil reported	59,629.39
Decrease in bonus oil	5,411.90

3. Depletion has been increased from $21,020.42 to $42,534.25 in accordance with section 204 (c) (2) of the revenue act of 1926.

The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 284 of the revenue act of 1926.

11 1926

Net income shown on return		$32,210.76
Add:		
1. Increase in oil income	$3,620.98	
Deduct:		
2. Depletion at 27½%	995.77	
		2,625.21
Net income adjusted		34,835.97

COMPUTATION OF TAX

Net income adjusted	$34,835.97
Less: Exemption	1,500.00
Income subject to normal tax	33,335.97
Normal tax, at 1½%, on $4,000.00	60.00
Normal tax, at 3%, on $4,000.00	120.00
Normal tax, at 5%, on $25,335.97	1,266.80
Surtax on $34,835.97	1,295.24
Total tax assessable	2,742.04
Less: Credit of 25% for earned income	13.13
Net tax assessable	2,728.91
Brought forward	2,728.91
Tax previously assessed	2,361.23
Deficiency in tax	367.68

Explanation of changes

1. Reconciliation of difference in royalty on oil received:

Harmel, A and B ⅛ royalty, Humble O. and R. Company	$18,412.10
12 Harmel, C ⅛ royalty, Humble O. and R. Company	31,869.84
Royalty income, Humble O. and R. Company	768.45
Mutual Oil Company, ⅛ royalty	3,482.71
Bonus oil received, Humble O. and R. Company	7,219.97
Phillips Petroleum Company (gas)	367.16
Total income, oil and gas, received	62,120.23
Total oil and gas income reported	58,499.25
Increase in oil and gas income	3,620.98

2. Depeltion has been increased from $16,087.29 to $17,083.06, in accordance with section 204 (c) (2) of the revenue act of 1926.

The right of petition, as indicated on page one of this letter, refers only to any deficiency in tax indicated herein, inasmuch as there is no provision in the revenue act of 1926 granting the right of petition against the determination of any overassessment found upon a review of your returns.

Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

Now, March 14, 1931, the foregoing petition certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

13 Before U. S. Board of Tax Appeals

Answer

Filed July 3, 1928

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph 1.

(2) Admits the allegations of fact contained in paragraph 2, and avers that said deficiency letter was mailed to the petitioner on April 4, 1928.

(3) Admits that the taxes in controversy are income taxes for the calendar years 1924 and 1926 in the amounts of $2,587.24 and $367.68, respectively, but denies that the board has jurisdiction of the year 1925 for the reason that the respondent did not propose a deficiency for that year.

(4) Denies that the respondent erred in the determination of said deficiency as alleged in subparagraphs (a) to (c), inclusive, of paragraph 4.

(5) Denies all material allegations of fact contained in subparagraphs (1) (a) to (5) (c), inclusive, of paragraph 5.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified, or denied.

14 Wherefore, it is prayed that the appeal be denied.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of counsel:

MAXWELL E. MCDOWELL,
Special Attorney, Bureau of Internal Revenue.

Now, March 14, 1931, the foregoing answer certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals

HENRY HARMEL, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 38,855. Promulgated March 24, 1920

The petitioner in 1924 executed oil and gas leases covering land owned by him. The leases provided, in addition to the usual royalty, for a cash consideration which was paid to the petitioner in that year. Held, that the leases were not sales of capital assets within the meaning of section 208 of the Revenue act of 1924, and that the petitioner is not entitled to the benefits of that section.

Robert Ash, Esq., for the petitioner.

J. Arthur Adams, Esq., for the respondent.

The respondent, by deficiency letter dater April 4, 1928,
15 asserted deficiencies in tax against the petitioner in the amount of $2,587.24 for 1924 and $367.68 for 1926, and determined an overassessment in the amount of $727.78 for the year 1925. It is alleged in the petition that the petitioner's tax liability for the three years mentioned is in controversy. At the hearing counsel for the petitioner abandoned the proceeding in so far as it involves the year 1926, and as to the year 1925 the proceeding was dismissed for lack of jurisdiction on the part of the board to hear and determine it.

FINDINGS OF FACT

The petitioner is an individual residing at Megargel, Texas. In the year 1924 the petitioner was, and had been for many years, the owner in fee simple of certain lands. In October, 1924, he executed two oil and gas leases covering said land on the basis of stipulated royalties and a cash consideration of $57,000.

In December, 1924, the petitioner's funds in the First State Bank of Megargel, Texas, became depleted and he, or his agent, on December 5, 1924, deposited in said bank to the account of the petitioner a check for $1,000 drawn on the First National Bank of Wichita Falls. On December 24, 1924, the petitioner or his agent deposited in said First State Bank of Megargel to the account of the petitioner a check for $500 drawn on the First National Bank of Wichita Falls. The said checks drawn on the First National Bank of Wichita Falls were against deposits made by the petitioner from the consideration received on the execution of the oil and gas leases mentioned.

The petitioner filed an income-tax return for 1924 and treated said amount of $57,000 as capital gain. The respondent, upon audit of the return, determined that said $57,000 is income at the ordinary rates, and he also added to the petitioner's income the said
16 amount of $1,500 deposited in the First State Bank of Megargel as "unidentified deposits not reported," and determined a deficiency in tax for 1924 in the amount of $2,587.24.

OPINION

MARQUETTE: It is clear that the respondent is in error with respect to the amount of $1,500 deposited by the petitioner in the First State Bank of Megargel, Texas, in December, 1924. These deposits were funds transferred from the bank of Wichita Falls to the bank of Megargel, and represented a part of the $57,000 received by the petitioner on the execution of certain oil and gas leases, which had already been included in the petitioner's income. The amount in question should be eliminated from the petitioner's income for 1924 as heretofore determined by the respondent.

The only other question is whether the cash consideration received by the petitioner in 1924 as a part of the consideration for the execution of certain oil and gas leases should be taxed as ordinary income or as capital gain, under the provisions of section 208 of the revenue act of 1924. This question has been considered by the board on a number of occasions and has been exhaustively discussed in Henry L. Berg et al. (6 B. T. A. 1287), John T. Burkett (7 B. T. A. 560), and James R. Parkey et al. (16 B. T. A. 441). In the last-named case it is stated:

"In John T. Burkett (7 B. T. A. 560) we were again confronted with the same question presented in the Berg case and with the same contention that the State law prevails. Following the Berg decision we again held that an ordinary oil and gas lease did not convey
17 title to the oil and gas and that such a lease did not constitute a sale of a capital asset within the meaning of section 207 of the revenue act of 1921. It is pertinent to point out that the Burkett case resembles these proceedings in that in addition to the usual royalty there was paid a cash consideration of $175,000.

"It is clear under the above authorities that petitioner James R. Parkey is not entitled to the benefits of section 206 of the revenue act of 1921 and of section 208 of the revenue act of 1924."

The Burkett case was affirmed by the Circuit Court of Appeals for the Eighth Circuit. (31 Fed. (2d) 667.) The court said:

"The gist of this instrument is that for a payment of $175,000 the oil company was given the right to prospect and produce the oil for a maximum term of 50 years under the conditions and upon the payments set forth therein.

"Whether this instrument can be described by any defined legal terms, such as lease, license, etc., it is certain that it is only a limited grant of a right in respect to land and for a limited period of time by one having the fee and possession. Such cannot be denominated a 'sale' in the ordinary sense of that word, and there is no reason to construe section 206 as using 'sale' in any other sense. The wording and the legislative history of section 206 are clear that it was intended to apply to 'sales' in the sense of conveyance of title to property, not of the creation of privileges or estates or rights in property for a limited period of time."

On the authority of the decisions cited we hold that the
18 leases executed by the petitioner did not constitute a sale of capital assets, and that he is not entitled to the benefit of section 208 of the Revenue Act of 1924.

Judgment will be entered under rule 50.

Now, March 14, 1931, the foregoing findings of fact and opinion certified from the record as a true copy.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before United States Board of Tax Appeals, Washington

Docket No. 38855

HENRY HARMEL, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Pursuant to opinion and findings of fact promulgated March 24, 1930, the respondent herein, to wit, on April 5, 1930, having filed a proposed redetermination for the years 1924 and 1926, and the petitioner on April 21, 1930, having filed notice of acquiescence to the said proposed redetermination, it is

Ordered and decided that there are deficiences for the years 1924 and 1926 in the amounts of $2,167.25 and $367.68, respectively.

(Signed) JOHN J. MARQUETTE,
Member.

19 Enter: Entered Apr. 25, 1930.
vlh.

Now, March 14, 1931, the foregoing decision certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

In United States Circuit Court of Appeals, Fifth Circuit

Petition for review of decision of the United States Board of Tax Appeals

Filed Oct. 25, 1930

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Fifth Circuit:

Henry Harmel, in support of this, his petition, filed in pursuance of the provision of section 1001 of the act of Congress approved February 26, 1926, entitled the "Revenue Act of 1926," for the review of the decisions of the United States Board of Tax Appeals rendered on the 25th day of April, 1930, approving a deficiency in income taxes of the petitioner for the calendar year 1924 in the amount of $2,167.25, respectfully shows to this honorable court as follows:

I

1. On May 23, 1928, petitioner filed with the United States Board of Tax Appeals, in pursuance of the revenue act of 1926, his petition requesting the redetermination of a deficiency in income
20 taxes for the calendar year 1924. The facts insofar as material to the questions herein presented were found by the board to be:

"The petitioner is an individual residing at Megargel, Texas. In the year 1924 the petitioner was, and had been for many years, the owner in fee simple of certain lands. In October, 1924, he executed two oil and gas leases covering said land on the basis of stipulated royalties and a cash consideration of $57,000.

"The petitioner filed an income-tax return for 1924 and treated said amount of $57,000 as capital gain. The respondent, upon audit of the return, determined the said $57,000 is income at the ordinary rates * * *."

2. On March 24, 1930, the board rendered an opinion on these facts and held:

"The only other question is whether the cash consideration received by the petitioner in 1924 as a part of the consideration for the execution of certain oil and gas leases should be as ordinary income or as capital gain, under the provisions of section 208 of the revenue act of 1924. This question has been considered by the board on a

number of occasions and has been exhaustively discussed in Henry L. Berg et al. (6 B. T. A. 1287), John T. Burkett (7 B. T. A. 560), and James R. Parkey et al. (16 B. T. A. 441). In the last-named case it is stated:

"'In John T. Burkett (7 B. T. A. 560), we were again confronted with the same question presented in the Berg case and with the same contention that the State law prevails. Following the Berg decision,

21 we again held that an ordinary oil and gas lease did not convey title to the oil and gas and that such a lease did not constitute a sale of a capital asset within the meaning of section 208 of the revenue act of 1921. It is pertinent to point out that the Burkett case resembles these proceedings in that in addition to the usual royalty there was paid a cash consideration of $175,000.

"'It is clear under the above authorities that petitioner James R. Parkey is not entitled to the benefits of section 206 of the revenue act of 1921 and of section 208 of the revenue act of 1924.'

"The Burkett case was affirmed by the Circuit Court of Appeals for the Eighth Circuit. (31 Fed. (2d) 667.) The court said:

"'The gist of this instrument is that for a payment of $175,000 the oil company was given the right to prospect and produce the oil for a maximum term of 50 years under the conditions and upon the payments set forth therein.

"'Whether this instrument can be described by any defined legal terms, such as lease, license, etc., it is certain that it is only a limited grant of a right in respect to land and for a limited period of time by one having the fee and possession. Such can not be denominated a "sale" in the ordinary sense of that word, and there is no reason to construe section 206 as using "sale" in any other sense. The wording and the legislative history of section 206 are clear that it was intended to apply to "sales" in the sense of conveyance of title to property, not of the creation of privileges or estates or rights in property for a limited period of time.'

"On the authority of the decisions cited we hold that the leases executed by the petitioner did not constitute a sale of capital assets, and that he is not entitled to the benefit of section 208 of the revenue act of 1924."

22 3. On the 25th day of April, 1930, the said board rendered its decision, approving a deficiency against the petitioner in the amount of $2,167.25 for the year 1924.

II

DESIGNATION OF COURT OF REVIEW

The petitioner being aggrieved by the said opinion and decision, and being an individual, desires a review thereof in accordance with section 1002 (a) of the review act of 1926, by the United States Circuit Court of Appeals for the Fifth Circuit, whereof he is an inhabitant.

III

ASSIGNMENT OF ERROR

The petitioner, as a basis of review, makes the following assignment of error:

1. The Board of Tax Appeals erred in ruling and/or finding that bonuses received for executing oil and gas leases in Texas are not taxable as capital gain.

Wherefore, the petitioner prays that the decision of the Board of Tax Appeals entered against him be reversed, and that the court grant such other and further relief as the court may deem meet and proper in the premises.

HENRY HARMEL,
Petitioner.

By ROBERT ASH,
T. J. REILLY,
Attorneys for Petitioner,
Munsey Building, Washington, D. C.

23 [*Duly sworn to by Robert Ash; jurat omitted in printing.*]

Now, March 14, 1931, the foregoing petition for review certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Before U. S. Board of Tax Appeals

Præcipe for transcript of record

Filed Oct. 25, 1930

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and on or before ———, 1930, transmit to the clerk of the United States Circuit Court of Appeals for the Fifth Circuit certified copies of the following documents in the above-entitled case:

24 1. Docket entries of proceedings before the United States Board of Tax Appeals.
2. Petition.
3. Answer.
4. Findings of fact and opinion of the board.
5. Decision (order of redetermination) of the board.
6. Petition for review to the United States Circuit Court of Appeals for the Fifth Circuit.
7. This designation of record.

The foregoing to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Fifth Circuit.

ROBERT ASH,
T. J. REILLY,
Attorneys for Petitioner,
Munsey Building, Washington, D. C.

Now, March 14, 1931, the foregoing præcipe certified from the record as a true copy.

[SEAL.]

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

25 In United States Circuit Court of Appeals, Fifth Circuit

[Title omitted.]

Stipulation as to leases

It is hereby stipulated by and agreed between G. A. Youngquist, Assistant Attorney General, and Robert Ash, attorney for Henry Harmel, that this stipulation and the following documents should be incorporated in the transcript of record in the above-entitled cause:

1. Copy of lease dated October 13, 1924, between Henry Harmel and E. R. Fain.
2. Copy of lease dated October 21, 1924, between Henry Harmel and J. A. Gardner.

G. A. YOUNGQUIST,
Assistant Attorney General.
ROBERT ASH,
Attorney for Petitioner.

JUNE 29, 1931.

Exhibit to stipulation

OIL AND GAS LEASE

Agreement, made and entered into the 13th day of October, 1924, by and between Henry Harmel, of Archer County, Texas, hereinafter called lessor (whether one or more), and E. R. Fain, hereinafter called lessee:

Witnesseth: That the said lessor, for and in consideration of twenty thousand and no/100 dollars and other consideration
26 hereinafter set forth, cash in hand paid, the receipt of which is hereby acknowledged, and of the covenants and agreements hereinafter contained on the part of the lessee to be paid, kept, and performed, has granted, demised, leased, and let, and by these presents does grant, lease, and let unto the said lessee for the sole and

only purpose of mining and operating for oil and gas and of laying pipe lines and of building tanks, power stations, and structures thereon to produce, save, and take care of said products, all that certain tract of land situated in the county of Archer, State of Texas, described as follows, to wit:

The west forty acres of the south one-half of T. E. & L. Co. survey No. 2401, with metes and bounds as follows, viz: Beginning at the southwest corner of said survey No. 2401; thence along west boundary line to a point in said line which is the southwest corner of an eighty-acre lease made to E. R. Fain on Sept. 8, 1924; thence east with the south boundary line of said eighty-acre lease 933⅓ feet to stake for corner; thence south to the south boundary line of said survey No. 2401; thence west to the place of beginning; ——— and containing 40 acres more or less.

It is agreed that this lease shall remain in force for a term of three years from this date, and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee.

In consideration of the premises the said lessee covenants and agrees:

1st. To deliver to the credit of lessor, free of cost, in the pipe line to which he may connect his wells, the equal of one-eighth part of all oil produced and saved from the leased premises.

27 2. To pay the lessor ⅛ value at wells ——— dollars each year in advance for the gas from each well where gas only is found, while the same is being used off the premises, and lessor to have gas free of cost from any such well for all stoves and all inside lights in the principal dwelling house on said land during the time by making his own connections with the well at his own risk and expense.

3rd. To pay lessor for gas produced from any oil well and used off the premises at the rate of ⅛ value at wells for such gas ——— dollars per year, for the time during which such gas shall be used, said payments to be made each three months in advance. Should the lessee desire to utilize casing-head gas coming from oil wells upon the premises herein described for the purpose of manufacturing gasoline, lessee shall have the privilege of so doing by paying to the lessor one ⅛ of the proceeds derived from the sale of said casing-head gas at the wells.

If no well be commenced on said land on or before the 13th day of October, 1925, this lease shall terminate as to both parties, unless the lessee on or before that date shall pay or tender to the lessor, or to the lessor's credit in the First State Bank at Megargel, Texas, or its successors, which shall continue as the depository, regardless of changes in the ownership of said land, the sum of eighty and no/100 dollars, which shall operate as rental and cover the privilege of deferring the commencement of a well for twelve months from said date. In like manner and upon like payments or tenders the commencement of a well may be further deferred for like periods of the same number of months successively. And it is understood and agreed that the consideration first recited herein, the down payment,

covers not only the privilege granted to the date when said first rental is payable as aforesaid, but also the lessee's option of extending that period as aforesaid, and any and all other rights conferred.

28 Should the first well drilled on the above-described land be a dry hole, then and in that event, if a second well is not commenced on said land within twelve months thereafter, this lease shall terminate as to both parties, unless the lessee on or before the expiration of said twelve months shall resume the payments of rentals in the same amount and in the same manner as hereinbefore provided. And it is agreed that upon the resumption of the payments of rentals, as above provided, that the last preceding paragraph hereof, governing the payment of rentals and the effect thereof, shall continue in force just as though there had been no interruption in the rental payments.

If said lessor owns a less interest in the above described land than the entire and undivided fee simple estate therein, then the royalties and rentals herein provided for shall be paid the said lessor only in proportion which his interest bears to the whole and undivided fee.

Lessee shall have the right to use, free of cost, gas, oil and water produced on said land for all operations thereon, except water wells of lessor.

When requested by lessor, lessee shall bury pipe line below plow depth.

No well shall be drilled nearer than 200 feet to the house or barn now on said premises without the written consent of the lessor.

Lessee shall pay for damages caused by all operations to growing crops on said land.

Lessee shall have the right at any time to remove all machinery and fixtures placed on said premises, including the right to draw and remove casing.

If the estate of either party hereto is assigned—and the privilege of assigning in whole or in part is expressly allowed—the cove-

29 nants hereof shall extend to their heirs, executors, administrators, successors, or assigns, but no change in the ownership of the land or assignment of rentals or royalties shall be binding on the lessee until after the lessee has been furnished with a written transfer or assignment, or a copy thereof; and it is hereby agreed that in the event that this lease shall be assigned as to a part or as to parts of the above described lands and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease so far as it covers a part or parts of said lands upon which the said lessee or any assignee thereof shall make due payment of said rental.

Lessor hereby warrants and agrees to defend the title to the lands herein described and agrees that the lessee shall have the right at any time to redeem for lessor, by payment, any mortgages, taxes, or other liens on the above described lands, in the event of default of payment by lessor, and be subrogated to the rights of the holder thereof.

The other consideration above mentioned is the sum of $20,000.00, which shall be paid to the lessor hereof out of one-half of seven-eights of the first oil produced on said land.

In testimony whereof, we sign, this the 13th day of October, 1924.

——— ———.

——— ———.

Witnesses:

——— ———.

——— ———.

U. S. Board of Tax Appeals, div. 1, docket 38855. Admitted in evidence Nov. 27, 1929. Petitioner's Exhibit 1.

30 *Exhibit to stipulation*

OIL AND GAS LEASE

Agreement, made and entered into the 21st day of October, 1924, by and between Henry Harmel, of Archer County, Texas, party of the first part, hereinafter called lessor (whether one or more), and J. A. Gardner, party of the second part, hereinafter called lessee.

Witnesseth: That the said lessor, for and in consideration of forty-four thousand and no/100 dollars, cash in hand paid, and the consideration hereinafter named, receipt of which is hereby acknowledged, and of the covenants and agreements hereinafter contained on the part of lessee to be paid, kept, and performed, has granted, conveyed, demised, leased, and let, and by these presents do grant, convey, demise, lease, and let unto the said lessee, for the sole and only purpose of mining and operating for oil and gas and of laying pipe lines and of building tanks, powers, stations, and structures thereon to produce, save, and take care of said products, all that certain tract of land situated in the county of Archer, State of Texas, described as follows, to wit:

The west eighty acres of land out of the east one hundred twenty acres of land of the south one-half of T. E. & L. Co. survey No. 2401; the north boundary line of said eighty acres being the south boundary line of a lease heretofore made in favor of E. R. Fain out of the north one-half of said survey, Abstract No. 581, and containing eighty acres, more or less.

It is agreed that this lease shall remain in force for a term of three years from this date, and as long thereafter as oil or gas, or either of them, is produced from said land by lessee.

In consideration of the premises the said lessee covenants and agrees:

31 1. To deliver to the credit of lessor, free of cost, in the tanks or pipe line to which he may connect his wells, the equal one-eighth part of all oil produced and saved from the leased premises.

2. To pay the lessor one-eighth value at wells ——— dollars each year in advance, for the gas from each well where gas only is found, while the same is being used off the premises, and lessor to have gas

free of cost from any such well for all stoves and all inside lights in the principal dwelling house on said land during the same time by making his own connection with the well at his own risk and expense.

3. To pay lessor for gas produced from any oil well and used off premises at the rate of ⅛ value at wells for such gas ——— dollars per year, for the time during which such gas shall be used, said payments to be made each three months in advance.

If no well is commenced on said land on or before the 21st day of Oct., 1925, this lease shall terminate as to both parties, unless on or before that date lessee shall pay or tender to the lessor, or to the lessor's credit in the First State Bank at Megargel, Texas, or its successors, which shall continue as the depository regardless of changes in the ownership of said land, the sum of one hundred sixty and no/100 dollars, which shall operate as a rental and cover the privilege of deferring the commencement of a well for twelve months from said date. In like manner and upon like payments or tenders the commencement of a well may be further deferred for like period of the same number of months successively. And it is understood and agreed that the consideration first recited herein, the down payment covers not only the privileges granted to the date when said first rental is payable as aforesaid, but also the lessee's option of extending that period as aforesaid, and any and all other rights conferred.

32 Should the first well drilled on the above-described land be a dry hole, then and in that event, if a second well is not commenced on said land within twelve months from the expiration of the last rental period for which rental has been paid this lease shall terminate as to both parties, unless the lessee on or before the expiration of said twelve months shall resume the payments of rentals in the same amount and in the same manner as hereinbefore provided. And it is agreed that upon the resumption of the payments of rentals, as above provided, that the last preceeding paragraph hereof, governing the payment of rentals and the effect thereof, shall continue in force just as though there had been no interruption in the rental payments.

If said lessor owns a less interest in the above-described land than the entire and undivided fee-simple estate therein, the royalties and rentals herein provided for shall be paid to the lessor only in proportion which his interest bears to the whole and undivided fee.

Lessee shall have the right to use, free of cost, gas, oil, and water produced on said land for its operations thereon, except water from wells of lessor.

When requested by lessor, lessee shall bury his pipe line below plow depth.

No well shall be drilled nearer than 200 feet to the house or barn now on said premises without the consent of the lessor.

Lessee shall pay for damages caused by his operations to growing crops on said land.

Lessee shall have the right at any time to remove all machinery and fixtures placed on said premises, including the right to draw and remove casing.

33 If the estate of either party hereto is assigned—and the privilege of assigning in whole or in part is expressly allowed—the covenants hereof shall extend to the assigns and successive assigns, but no change in the ownership of the land or assignment of rentals or royalties shall be binding on the lessee until after the lessee has been furnished a written transfer or assignment or a true copy thereof; and it is hereby agreed that in the event that this lease shall be assigned as to a part or as to parts of the above-described lands, and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease in so far as it covers a part or parts of said lands upon which the said lessee or any assignee thereof shall make due payment of said rental.

Lessor hereby warrants and agrees to defend the title to the lands herein described and agrees that the lessee shall have the right at any time to redeem for lessor, by payment, any mortgage, taxes, or other liens on the above-described lands, in the event of default in payment by lessor, and be subrogated to the rights of the holder thereof.

In addition to the cash consideration above mentioned, a further consideration of forty-four thousand dollars is to be paid by lessee to the lessor hereof out of one-half of seven-eighths of the first oil produced from said land, and a vendor's lien is retained against said leasehold estate and the oil produced therefrom until the full sum of forty-four thousand dollars is paid. It is further agreed by the parties hereto that lessee shall drill two wells on the said eighty-acre tract to the depth of the pay sand found in this field, the first well to be begun on or before fifteen days from the

34 date hereof and the second well to be begun on or before forty-five days from the date hereof, anything in this contract to the contrary notwithstanding. It is further agreed that in the event lessee shall fail or refuse to begin the drilling of either of the wells above specified in the time specified or shall fail to drill either well to the depth specified, then this contract shall forfeit and shall become null and void and shall revert to the lessor hereof.

It is agreed by the parties hereto that lessee shall begin actual drilling operations on the above-described land within 10 days from the date hereof. In the event lessee shall not begin actual drilling operation on or before the expirations of said ten days this contract shall terminate as to all parties and the $20,000.00 cash consideration shall remain the property of lessor as liquidated damages.

U. S. Board of Tax Appeals, div. 1, docket 38855. Admitted in evidence Nov. 27, 1929. Petitioner's Exhibit 2.

No. 6212. United States Circuit Court of Appeals, Fifth Circuit. Henry Harmel, petitioner, vs. Commissioner of Internal Revenue, respondent. Stipulation.

Now, June 26, 1931, the foregoing petitioner's Exhibits Nos. 1 and 2 certified from the record as true copies.

[SEAL.] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

35 [Minute entry of argument and submission, Feb. 16, 1932, omitted in printing.]

36 In United States Circuit Court of Appeals for the Fifth Circuit

No. 6212

HENRY HARMEL, PETITIONER

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review of decision of the U. S. Board of Tax Appeals (District of Texas)

(February 23, 1932)

Before BRYAN, FOSTER, and WALKER, Circuit Judges

Opinion

Filed February 23, 1932

BRYAN, Circuit Judge: This is a petition by a taxpayer to review a decision of the Board of Tax Appeals which held that $57,000, received in 1924 as cash consideration for an oil and gas lease of land in Texas, was taxable as ordinary income. The taxpayer contended that the amount so received should have been taxed as capital gain under § 208a (1), revenue act of 1924, which provides: "The term 'capital gain' means taxable gain from the sale or exchange of capital assets."

The same question was decided in favor of a taxpayer by this court in Ferguson v. Commissioner (45 F. (2) 573), and we
37 see no reason to reverse our ruling in that case. We there held that in Texas, however it might be in other States, an oil and gas lease conveyed a determinable fee to those minerals in place, and that this local rule of property was controlling in the absence of congressional legislation restricting the meaning of the word "sale." Since then the Supreme Court, in group No. 1 Oil Corporation v. Bass 283 U. S. 279), following Theisen v. Robison (117 Tex. 489), likewise has held that an oil and gas lease constitutes a present sale of

the oil and gas in place, under the constitution and law of Texas. It is no new doctrine that a rule of property prevailing in a State, and changes in that rule, will be recognized in administering the Federal income tax law. (United States v. Robbins, 269 U. S. 315; United States v. Malcolm, 282 U. S. 792. See also the community income-tax cases of Poe v. Seaborn, 282 U. S. 101; Goodell v. Koch, 282 U. S. 118; Hopkins v. Bacon, 282 U. S. 122; Bender v. Pfaff, 282 U. S. 217.)

The petition for review is granted, and the cause remanded for further proceedings not inconsistent with this opinion.

38 In United States Circuit Court of Appeals

No. 6212

HENRY HARMEL

versus

COMMISSIONER OF INTERNAL REVENUE

Judgment

February 23, 1932

This cause came on to be heard on the petition of Henry Harmel for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this court that said petition be, and the same is hereby granted; and that this cause be, and it is hereby, remanded to the said United States Board of Tax Appeals for further proceedings not inconsistent with the opinion of this court.

39 In United States Circuit Court of Appeals for the Fifth Circuit

[Title omitted.]

Motion for order staying mandate filed

March 14, 1932

Now comes the respondent in the above-entitled cause, by C. M. Charest, General Counsel, Bureau of Internal Revenue, his attorney, and moves the court for a stay of mandate herein for a period of three months, pending an application for certiorari to the Supreme Court of the United States.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue,
Attorney for respondent.

40 In United States Circuit Court of Appeals for the Fifth Circuit

[Title omitted.]

Order staying mandate

March 14, 1932

On consideration of the application of the respondent in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable respondent to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, it is ordered that the issue of the mandate of this court in said cause be, and the same is, stayed for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate of the clerk of the Supreme Court that the certiorari petition and record have been filed, and that due proof of service of notice thereof under paragraph 3 of rule 38 of the Supreme Court has been given. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

Done at New Orleans, La., this 14th day of March, 1932.

(Signed) N. P. BRYAN,
United States Circuit Judge.

41 [Clerk's certificate to foregoing transcript omitted in printing.]

42 Supreme Court of the United States

Order allowing certiorari

Filed April 18, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Indorsement on cover:] Enter. Attorney General. File No. 36638. U. S. Circuit Court of Appeals, Fifth Circuit, term No. 824. David Burnet, Commissioner of Internal Revenue, petitioner, vs. Henry Harmel. Petition for a writ of certiorari and exhibit thereto. Filed March 24, 1932. File No. 36638.

U. S. GOVERNMENT PRINTING OFFICE: 1932